Fall 2012

In Focus
San Diego Real Estate

Executive Summary

- *San Diego ranks 4th in the nation in job gains over past year*
- *The County of San Diego added 35,000 new jobs — a substantial addition of demand for housing*
- *New construction of new sale housing remains dismal*
- *Home prices rising steadily as demand outstrips available inventory*
- *Commercial real estate remains highly attractive to U.S. investor market, particularly apartments and retail centers*

In This Issue

Finally, a Real Home Market Recovery Begins

Gary London

Where does the housing market stand? The short answer is that it is almost standing up on its own two feet.

The transition from a recession-based housing market to a recovery-based one falls to the following factors: number of total transactions; percent of distressed sales; trend of price increases; amount of standing or developable inventory.

My bottom line is that when measured together, these factors tell us what we need to know about the market. Freddie Mac reports that the 4.8 percent quarter-on-quarter rise was the biggest since 2004. This is a powerful sign.

The number of total transactions in the San Diego region has climbed from 2,200 sales per month in 2008, to 2,450 sales per month last year at this time, to 2,750 sales per month.

The percentage of trustee sales peaked at 17% in 2008 and 10% in 2011 and 6% today.

This matters because it is an indicator that there is a transition of market activity from the "have to" seller to the "want to" seller. This trend is also likely to continue, although, there is still the factor of homeowners who are "underwater," with a lot of so called "negative equity," which will fester the housing market for some time to come.

Back to the Bubble?

Trend of price increases: We have never experienced a period in the modern era in which the peak price of the last bubble wasn't exceeded by the peak price of the next. Housing prices have always evolved up, despite ups and downs along the way. While this last bubble peak raised the bar, and one could argue how anyone could afford those prices in the future, somehow they do. I fully expect prices to eventually reach another peak high — although I wouldn't know how long that is going to take. So, the bottom line is that over the past few months the San Diego residential market has reached the "inflection point" where the market has crossed from distressed to improving.

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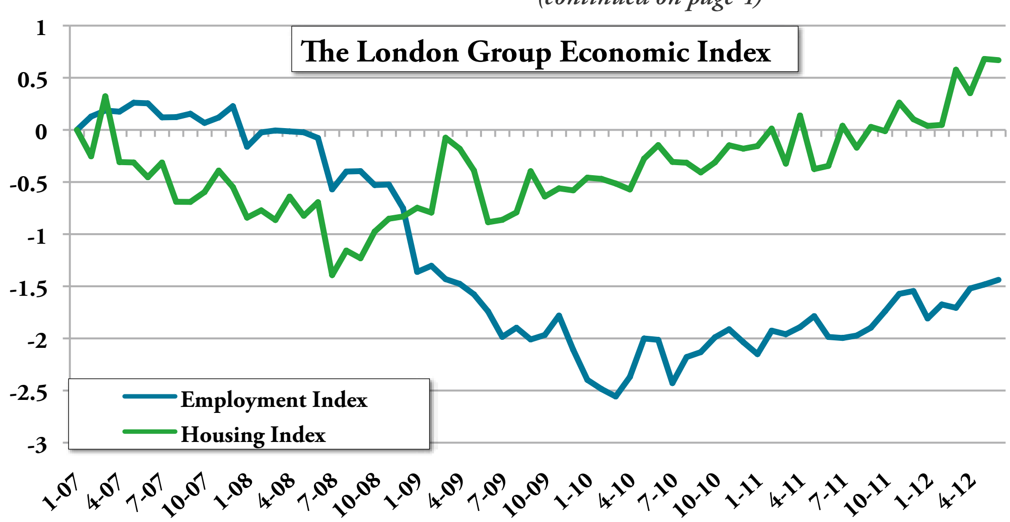

San Diego Commercial Properties: A National Favorite for Investors

Chris Lisle

San Diego's commercial property markets have suffered during the recession, but only selectively. Two components of the market hardly suffered at all: **apartments** and **retailing**.

will be delivered over the extended 2013-2016 period, adding 2% to the County's 300,000+ apartment inventory. Most of the new units are luxury quality and will rent for $2.00-3.00 per square foot.

2012 Emerging Trends in Real Estate: Economic Rankings
Urban Land Institute

Category	San Diego Ranking	Market with #1 Rating
Buy Recommendations		
Apartments	4	San Francisco
Office	6	San Francisco
Retail	6	Seattle
Industrial	7	Seattle

Apartment Properties

Where most Sunbelt markets saw substantial overbuilding, 10%+ vacancy rates and devastating declines in rents, San Diego continued to power through, experiencing virtually none of the dysfunctional problems of the other markets.

This was the result of two factors: there had been virtually no new apartment construction in the years prior to the recent recession and, population continued to expand.

Vacancy rates entering the recession ranged from 5-6% and only increased to 6-7% during the recession. Today, vacancies are now back to the 5-6% range (some sources suggest lower). Further, the San Diego region experienced virtually no change in rents during the recession, and with relatively few concessions.

Capitalization rates also declined during the recession and now stand in the 5-6% range for middle-of-the-road properties. Investor grade properties have, of late, experienced cap rates as low as 3-4%.

This advantageous market condition has spawned a new round of construction throughout the region. Our research suggests that Downtown San Diego has more than 3,000 rental units in the planning stage, with three projects already underway. Throughout the region the new projects will total more than 6,000 units, but

Retail Properties

Retailing largely bypassed the recession unscathed from a "real estate metric" perspective, particularly in the better quality centers, including the regional centers. While there has been a dynamic exchange taking place over the past six years which has resulted in space being alternatively occupied by new retail concepts, the net occupancies have remained mostly intact.

Currently, the vacancy rates in neighborhood and community centers are 7.0% and in regional centers 4.0%. Rents in San Diego are 13th highest in the nation at $25.00 per square foot (highest is Manhattan at twice that). California contains 6 of the top 15 markets in the country in terms of rent levels.

This is the fourth consecutive quarter of positive absorption. Most of the 50+ big boxes that were vacated at the depth of the recession have been released. Fortunately, San Diego never experienced a major retail expansion prior to the recession. Other markets faltered. unlike Phoenix, for instance, at one time contained 500 empty big box spaces. There is virtually no retail construction underway. Most retail construction in 2012-2013 will be renovation. One exception: Sudberry Properties' 200,000+ Watermark lifestyle center on I-15.

Office and Industrial Markets

The office and industrial markets remain the weak spots in the local economy. The industrial market is gradually gaining strength, however, and now has a vacancy rate of 10.6%, compared to its high point of 12.3% in 2010. The declining vacancies relates to a dearth of new construction and strong absorption in the first half of 2012. In the first half of 2012, more space was absorbed than in all of 2011. Better yet, San Diego had the 3rd highest industrial space rents in the Nation at $7.20 NNN per square foot (annual), reflecting perhaps that these spaces are now being "repurposed" by higher end occupants.

The office sector has suffered the most relative to the other commercial space markets. The County's overall vacancy

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San Diego: Job Gains — 4th Best in U.S.

Alan Nevin

The West Coast has been experiencing a bonanza in job growth during the past year. Six of the top metropolitan areas with job gains in the Nation, on a percentage gain basis, are hugging the Pacific Ocean. San Diego is tied for 4th place California ranks No. 1 in job gains among all states with more than one million persons. California gained 365,000 new payroll jobs since last July. Nearby Arizona ranked 3rd in the Nation, indicating the first signs of recovery in that beleaguered state.

San Diego added more than 35,000 new jobs in the past year, 30,000 of them in the private sector. The top four job gain categories were business and professional services, leisure and hospitality, retailing and health care. Those four categories accounted for five of every six new jobs.

The San Diego Region's unemployment rate declined to 9.2%, but that rate does not include the military (115,000) and the crossborder-dayworkers (30,000). If those two categories were to be included, our region's unemployment rate drops to near 8.0%. That rate ranks San Diego among the lowest unemployment rate of any major U.S. metropolitan area.

San Diego's future is secured by its

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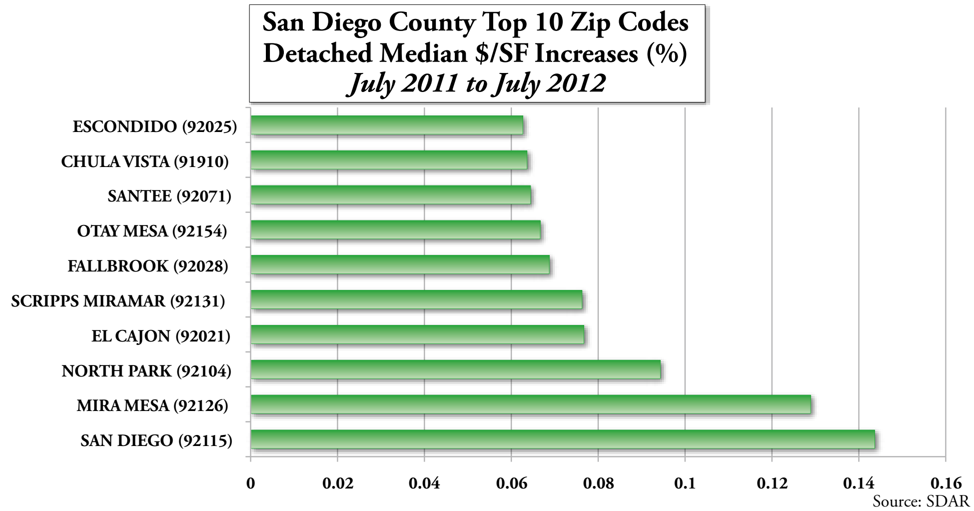
Price Increases — Top 10 Zip Codes

We have completed an extensive analysis of single family detached prices by zip code for San Diego County. We concentrated on the 33 zip codes (out of 90) that had more than 30 SDAR sales in the month of July 2012. We looked at the sales in terms of dollar per square foot which is statistically a more valid basis for analysis than just averages or medians. Using dollar per square foot takes into account home size– something that is not accounted for in median or average price metrics.

In the 33 zip codes, the median change in sales price per square foot was 2.6% from July 2011 to July 2012. Most of the 33 zip codes experienced little change, but ten of them showed significant increases. The top ten increases ranged from 6.3% (Escondido) to 14.4% in 92115 (SDSU area).

The second highest rate of increase is in 92126 (Mira Mesa) where the median price per square foot increased 12.9%.

We did look at a few selected high volume zip codes for attached housing. Several zip codes showed significant median prices per square foot increases. All of the following experienced increases of more than 7.0% from July 2011 to July 2012: downtown San Diego (92101); Mission Valley (92108); Pacific Beach (92109) and Hillcrest (92103).



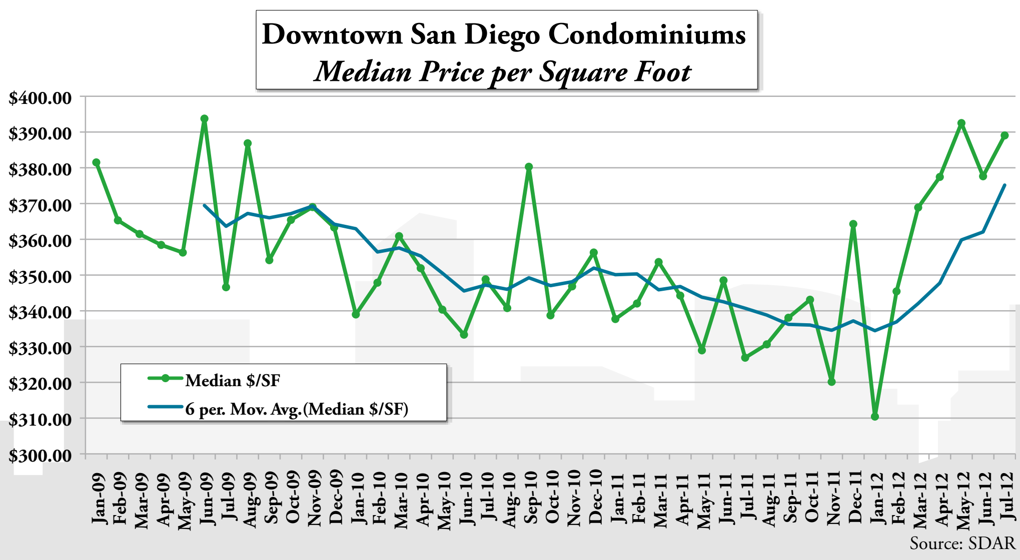
Downtown Awakens

Robert Martinez

Condominiums in Downtown San Diego, on a downward slide since 2006, are beginning to reverse course. Downtown's condominiums are experiencing the first sustained median price per square foot increase in more than six years. Since bottoming in January of this year, the median has increased in five of the next six months. The current median is hovering in territory not seen since early 2009.

So why now? With fewer than 200 condominiums listed on the MLS for sale as of the writing of this article, supply is obviously tight. New condominium construction has been non-existent for some time with nothing notable on the horizon. Additionally, mortgage interest rates continue to set record lows. It is also likely that there are fewer sellers who are listing their units because they have to rather than those who list because they want to.

This "perfect storm" has Downtown San Diego poised to experience steady price increases. More likely though is a sustained rate of price escalation as sellers cautiously push the limits of the market.



San Diego: Job Gains

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diversity of employment. Where many metropolitan areas have one or two basic employment sources, San Diego County has seven: the military, manufacturing, tourism, bio-tech, import-export, telecommunications and the universities.

Looking to the future, the picture looks particularly bright for the health-care sector which involve bio-tech, telecom, and manufacturing and, of course, the universities. Of the 30 professions that the Federal government projects will be the leading sources of jobs during the next decade, 16 of them are in the health care related fields.

The region's growing job base augurs well for both the residential and commercial real estate businesses. The demand for new housing is projected to outstrip the supply, as few new homes and condominiums are being built. Based on the County's 1.6 jobs per household ratio, more than 20,000 new households were formed during the past year, the key factor that has resulted in a rising demand for homes and condominiums and is driving up prices. As many of these new households achieve substantial incomes, sales in the upper end of the market should be favorable, just as the lower end has been in the past two years.

San Diego Real Estate
In Focus

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San Diego Association of REALTORS®
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Home Market Recovery

(continued from page 1)

If you are a REALTOR® you already know this, as you see multiple offers on listings, price increases and good homes coming to the market, and shorter listing-to-sale durations.

The **new home sale market** will be very slow to recover, as that sector is victimized by, among other things, too few builders, reluctant lenders, extremely limited land inventory, an arduous and unpredictable entitlement process and a general change in what can be delivered (including detached homes and condominiums).

This means that the inventory of available housing will remain mostly resales, as it has been over the past six years, and at the present pace the supply of listings will habitually trail demand. This will equate to price pops in the market.

Don't get too excited. Real estate markets move at a snail's pace. This recovery is slow and could still sputter. Consumer confidence could be hit. But don't count on it. This recovery seems real.

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Commercial Properties

(Continued from page 2)

rate is 18%, down from 21% in 2009. Like industrial, net absorption of office space in the first half of 2012 approximates the total absorption in 2011.

The office market continues to suffer from space consolidation, as the traditional large private office environment that once assumed a holy grail of a 4:1,000 ratio (i.e, four employees per 1,000 square feet) is quickly moving toward a 6:1,000 ratio. Not promising for the future of office construction. Overall, San Diego remains one of the favorite investment markets in the Nation for commercial properties, generally ranked in the top ten in all categories.

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